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February 25, 2011

Via Overnight Delivery

Ms. Sarabeth Snuggs
State Retirement Director
Division of Retirement
1317 Winewood Boulevard, Building 8
Tallahassee, FL 32399

Re: Study Reflecting the Impact to the Florida Retirement System of Modifying the Definitions of "Compensation" and "Average Final Compensation" for All Members Effective After July 1, 2011

Dear Sarabeth:

As you requested, we have studied the impact to the Florida Retirement System of the Senate proposal to modify the definitions of "Compensation" and "Average Final Compensation" to exclude overtime and lump-sum annual leave payments, effective for all members July 1, 2011.

Background

Currently, the FRS definition of "Average Final Compensation" includes overtime pay and accumulated annual leave payments not to exceed 500 hours. The proposal would exclude overtime and lump-sum annual leave payments from the definitions of "Compensation" and "Average Final Compensation" used to determine retirement benefits for FRS current and future members effective July 1, 2011.

Assumptions and Analysis

The proposal would affect all current and future active members effective July 1, 2011. Excluding overtime and annual leave payments from the definitions of "Compensation" and "Average Final Compensation" (AFC) would provide a savings to FRS by reducing the AFC used in determining members' benefits, and thereby reducing the monthly benefit. In determining a member's AFC, Compensation from pre-effective date plan years would continue to be based on the current definition of Compensation. Because of this there may be current members with considerable amounts of overtime whose final AFC will not change from the current levels for many years.

The Division of Retirement provided data files of current actives who received overtime compensation during the plan year ending June 30, 2010. After removal of duplicates, the data included 97,195 records receiving $283.8 million in overtime compensation. We matched these records to the active members included in the July 1, 2010 valuation. There were 76,930 matching records with a total of $220.2 million in overtime compensation. We reduced the valuation payroll of the matching active records by the overtime compensation provided by the Division, and re-ran the July 1, 2010 valuation for active members.

The Division of Retirement compiled the overtime compensation data based on surveys submitted to all FRS agencies. The returned surveys included information on current actives who did not receive any overtime during the plan year ending June 30, 2010. Because all of the agencies did not respond, we used the actual overtime compensation reported by the responding agencies, along with the reports of no overtime paid as the basis for the overtime compensation paid by the non-responding agencies. As a proportion of total payroll, 79.32% of agencies responded. Thus, we assumed $220.2 million in overtime compensation represented 79.32% of actual overtime compensation paid to members in the July 1, 2010 active valuation, and adjusted the results accordingly.

Currently, the valuation assumes a lump sum annual leave payout in the amount of 139 hours is credited to each retiring member to increase salary used for calculating the retirement benefits. We have removed this assumption for purposes of this study.

Results

The results for this study are shown in Table I as described below. The table details the results by class. The contribution rates are presented by class of membership and in aggregate, and reflect the increase/(decrease) in the contribution rate.

Section A of Table I includes the normal cost as of the July 1, 2010 valuation, and the impact of the proposal. In addition, the change in liability attributable to the proposal was amortized over 30 years with the payments assumed to remain relatively stable when expressed as a percentage of payroll. Section B of the table shows the change in the unfunded actuarial liability, while Section C of the table translates the estimated change in contribution rates to a reduction in dollars to be paid by employers.

As shown in Table I, the projected impact of the proposal results in a net reduction to the System. The projected decrease in the actuarial liabilities is $1.7 billion. This benefit change results in a decrease in the composite Normal Cost rate of 0.17% and a decrease in the composite UAL rate of 0.31%, and therefore, an overall decrease in contribution levels of 0.48%, for the total composite rate for the System. This translates into an estimated overall employer contribution reduction of $ 192 million for Fiscal Year 2011-2012.

Besides the change in contribution rates, adoption of this proposal would reduce the payroll base for both Normal Cost contributions and UAL contributions. The expected decreases in UAL payroll for the affected membership classes partially offset the reduction in UAL rates attributable to this proposal, because the amortization of the current UAL comprises a larger percentage of the smaller UAL payroll. Thus the Additional/(Reduced) dollars in the aforementioned Section C of the table incorporate both the changes in contribution rates and the adjusted payroll bases.

The calculations are based on data and other information provided to us by the Division of Retirement for the July 1, 2010 actuarial valuation and supplemented for purposes of this study. We have not audited or verified this data and other information. If the underlying data or information is inaccurate or incomplete, the results of our analysis may likewise be inaccurate or incomplete.

We performed a limited review of the data used directly in our analysis for reasonableness and consistency and have not found material defects in the data. If there are material defects in the data, it is possible that they would be uncovered by a detailed, systematic review and comparison of the data to search for data values that are questionable or for relationships that are materially inconsistent. Such a review was beyond the scope of our assignment.

This analysis is based on methods and assumptions used in the July 1, 2010 actuarial valuation, and the additional assumptions discussed earlier in this letter. The data was based on the July 1, 2010 FRS actuarial valuation database. The results of our study depend on future experience conforming to those actuarial assumptions. It is certain that actual experience will not conform exactly to the assumptions used in this analysis. To the extent future experience deviates from those assumptions, the results of this analysis could vary from the results presented here.

Milliman's work product was prepared exclusively for the internal business use of Florida Department of Management Services, Division of Retirement for a specific and limited purpose. It is a complex technical analysis that assumes a high level of knowledge concerning the Florida Retirement System's operations, and uses Division data, which

Milliman has not audited. To the extent that Milliman's work product is not subject to disclosure under applicable public record laws, Milliman's work may not be provided to third parties without Milliman's prior written consent. Milliman does not intend to benefit or create a legal duty to any third party recipient of its work product. Milliman's consent to release its work product to any third party may be conditioned on the third party signing a Release, subject to the following exceptions:

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(b) The Division of Retirement may provide a copy of Milliman's work, in its entirety, to other Governmental entities, as required by law.

No third party recipient of Milliman's work product should rely upon Milliman's work product. Such recipients should engage qualified professionals for advice appropriate to their own specific needs.

The consultants who worked on this assignment are pension actuaries. We have not explored any legal issues with respect to the proposed plan changes. We are not attorneys and cannot give legal advice on such issues. We suggest that you review this proposal with counsel.

I, Robert Dezube, am a consulting actuary for Milliman, Inc. I am also a member of the American Academy of Actuaries, and meet their Qualification Standards to render the actuarial opinion contained herein.

Please call if you would like to further discuss this project.

Sincerely,

Milliman, Inc.

Robert S. Dezube, FSA
Consulting Actuary

Enclosures

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FLORIDA RETIREMENT SYSTEM
FISCAL IMPACT ANALYSIS

Impact of Modifying the Definitions of "Compensation" and "Average Final Compensation" for All Members Effective July 1, 2011

	FRS	-----Special Risk-----		------Elected Officers' Class----			Senior	Composite		
	Regular	Regular	Administration	Judicial	Leg-Atty-Cab	County	Management	(excluding DROP)	DROP	Composite
A. Contribution Rates										
1. Present System Employer Costs (as reported the July 1, 2010 valuation - Table IV-4)										
a. Normal Cost	9.84%	22.34%	11.26%	19.42%	14.74%	16.79%	11.84%	11.81%	13.79%	11.96%
b. UAL Cost	2.23%	6.72%	25.84%	11.90%	26.72%	26.90%	12.54%	3.16%	5.78%	3.35%
c. Total Cost - FY 2012	12.07%	29.06%	37.10%	31.32%	41.46%	43.69%	24.38%	14.97%	19.57%	15.31%
2. Change in Contribution Rates due to Proposal Effective FY 2012 if Paid by Employer										
a. Normal Cost	-0.13%	-0.27%	-0.16%	-0.25%	-0.19%	-0.22%	-0.15%	-0.15%	-0.37%	-0.17%
b. Amortization of UAL Cost	-0.27%	-0.73%	-0.40%	-0.33%	-0.31%	-0.32%	-0.30%	-0.35%	0.00%	-0.31%
c. Total Change in Cost	-0.40%	-1.00%	-0.56%	-0.58%	-0.50%	-0.54%	-0.45%	-0.50%	-0.37%	-0.48%
B. Additional/(Reduced) Unfunded Liability due to Proposal (000 omitted)	($1,039,426)	($602,617)	($174)	($6,007)	($349)	($2,514)	($27,789)	($1,678,876)	$0	($1,678,876)
C. Additional/(Reduced) Dollars (Normal Cost and Amortization of UAL Cost) Due to Proposal to be paid by Employer for FY 2012 (000 omitted)										
1. State	($13,826)	($17,925)	($12)	($634)	($34)	$0	($1,102)	($33,533)	($1,440)	($34,973)
2. School Boards	($54,448)	($407)	$0	$0	$0	($51)	($245)	($55,151)	($3,436)	($58,587)
3. State Universities	($8,327)	($421)	$0	$0	$0	$0	($71)	($8,819)	($378)	($9,197)
4. Community Colleges	($3,819)	($34)	$0	$0	$0	$0	($114)	($3,967)	($271)	($4,238)
5. Counties	($19,960)	($52,600)	($2)	$0	$0	($174)	($651)	($73,387)	($1,794)	($75,181)
6. Other	($5,433)	($4,258)	($1)	$0	$0	($25)	($271)	($9,988)	($318)	($10,306)
7. Total	($105,813)	($75,645)	($15)	($634)	($34)	($250)	($2,454)	($184,845)	($7,637)	($192,482)

This work product was prepared solely for the Department of Management Services for the purposes described herein and may not be appropriate to use for other purposes. Milliman does not intend to benefit and assumes no duty or liability to other parties who receive this work.